

Audit



Report

OFFICE OF THE INSPECTOR GENERAL

COMPILATION OF THE FY 1996 FINANCIAL
STATEMENTS FOR OTHER DEFENSE ORGANIZATIONS

Report No. 98-062

February 4, 1998

Department of Defense

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Acronyms

CFO	Chief Financial Officers
DFAS	Defense Finance and Accounting Service
GLAC	General Ledger Account Code
IG	Inspector General
OMB	Office of Management and Budget



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February 4, 1998

**MEMORANDUM FOR DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE
DIRECTOR, DEFENSE FINANCE AND ACCOUNTING
SERVICE INDIANAPOLIS CENTER**

**SUBJECT: Audit Report on the Compilation of the FY 1996 Financial Statements for
Other Defense Organizations (Report No. 98-062)**

We are providing this audit report for review and comments. This audit was performed in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994.

DoD Directive 7650.3 requires that all recommendations be resolved promptly. Because the Director, Defense Finance and Accounting Service Indianapolis Center, did not comment on the draft report, we request that he provide comments on the final report by April 6, 1998.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Charles J. Richardson, Audit Program Director, at (703) 604-9582 (DSN 664-9582), e-mail CRichardson@dodig.osd.mil, or Mr. Marvin L. Peek, Audit Project Manager, at (703) 604-9587 (DSN 664-9587), e-mail MPeek@dodig.osd.mil. See Appendix D for the report distribution. The audit team members are listed inside the back cover.

Robert J. Lieberman
Assistant Inspector General
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Office of the Inspector General, DoD

Report No. 98-062
(Project No. 7RF-2009.02)

February 4, 1998

Compilation of the FY 1996 Financial Statements for Other Defense Organizations

Executive Summary

Introduction. This is the third and final report on the Defense Finance and Accounting Service (DFAS) Indianapolis Center's compilation of the FY 1996 financial statements for Other Defense Organizations. This report also summarizes conditions affecting the compilation process as reported in previous Inspector General, DoD, audit reports. We performed the audit in response to the Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, which requires that DoD provide audited financial statements to the Office of Management and Budget.

The DoD consolidated financial statements for FY 1996 included financial statements for a new reporting entity entitled "Other Defense Organizations." The entity represents a consolidation of financial information from various Defense agencies and organizations. The DFAS Indianapolis Center is responsible for preparing financial statements for Other Defense Organizations from information generated by multiple accounting systems and submitted by 23 accounting offices. During FY 1996, the 42 Defense organizations, funds, and accounts included in Other Defense Organizations were appropriated \$39 billion, and their financial statements showed total assets of \$45.7 billion, liabilities of \$2.7 billion, revenues and financing sources of \$46.7 billion, and expenses of \$46.5 billion.

Audit Objective. The overall audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled data received from field accounting organizations and other sources for the financial statements for Other Defense Organizations. Specifically, we evaluated whether the compilation of Other Defense Organizations financial information for the FY 1996 financial statements was complete, and whether the Notes to the financial statements fully disclosed material discrepancies and additional information relevant to the statements. In addition, we evaluated internal controls and compliance with laws and regulations as they related to our audit objectives.

Audit Results. DFAS Indianapolis Center produced financial statements for Other Defense Organizations for the first year of the new reporting entity by using information from certified budgetary reports and trial balances submitted for Other Defense Organizations. DFAS used information from certified "Report(s) on Budget Execution" because of a lack of reliable information from supporting accounting systems. However, the compilation process used by the DFAS Indianapolis Center

needed improvements to ensure that the financial statements prepared for Other Defense Organizations were complete, consistent, accurate, and fully supported. Specifically, the DFAS Indianapolis Center:

- made year-end adjustments, totaling \$88.3 billion, to the FY 1996 trial balances submitted by the supporting accounting offices that were not fully supported;
- understated the financial statements by \$207 million in assets, \$1.4 billion in liabilities, \$308 million in net position, and \$2.2 billion in expenses by omitting information from certain appropriations; and
- did not prepare all required Notes to the financial statements, and when prepared, the Notes were not accurate and complete.

As a result, the FY 1996 Other Defense Organizations financial statements compiled by the DFAS Indianapolis Center were not reliable and did not accurately or completely present the financial condition and results of operations.

Summary of Recommendations. We recommend that the DFAS Indianapolis Center include all required Notes to the financial statements, disclose deficiencies in accounting systems that could affect the reliability of balances, and fully explain summary adjustments made to trial balances submitted by supporting accounting offices. Prior audit reports have made recommendations on coordinating adjustments with supporting accounting offices, including financial information from all required appropriations, use of summary accounts, and correcting computer programming errors.

Management Comments. The Director, Defense Finance and Accounting Service Indianapolis Center, did not comment on the report. Therefore, we request that the Director provide comments on the final report by April 6, 1998.

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Part I - Audit Results

Audit Background

Requirement to Prepare Financial Statements. Public Law 101-576, the Chief Financial Officers (CFO) Act of 1990, November 15, 1990, requires Federal organizations to submit audited financial statements to the Director, Office of Management and Budget (OMB). Public Law 103-356, the Federal Financial Management Act of 1994, October 13, 1994, requires DoD and other Government agencies to prepare consolidated financial statements for FY 1996 and each succeeding year. In a memorandum dated June 6, 1995, the Deputy Chief Financial Officer, DoD, notified DoD Components of the FY 1996 requirement to prepare and submit financial statements in accordance with the Federal Financial Management Act of 1994.

FY 1996 Financial Statements for Other Defense Organizations. The DoD consolidated financial statements for FY 1996 include financial information for a reporting entity entitled "Other Defense Organizations." This entity includes appropriations, funds, and accounts using Treasury Index No. 97 (Department 97). The majority of Department 97 funds included in Other Defense Organizations are general funds appropriated for Defense agencies and organizations, including Defense-wide funds entrusted to the Military Departments. In FY 1996, the 42 Defense organizations, funds, and accounts included in Other Defense Organizations were appropriated \$39 billion to perform their missions and functions. The FY 1996 financial statements for Other Defense Organizations showed total assets of \$45.7 billion, liabilities of \$2.7 billion, revenues and financing sources of \$46.7 billion, and expenses of \$46.5 billion.

Financial Statement Guidance. Guidance for the preparation and presentation of the financial statements required by the CFO Act is contained in the "Statement of Accounting Standards" of the American Institute of Certified Public Accountants; OMB Bulletin Nos. 94-01 and 97-01, "Form and Content of Agency Financial Statements" (OMB Form and Content Guidance), November 16, 1993 and October 16, 1996; the "DoD Guidance on Form and Content of Financial Statements for FY 1996 Financial Activity"¹ (DoD Form and Content Guidance), October 1996; DoD 7000.14-R, the "DoD Financial Management Regulation;" and "Treasury Index 97 FY 1996 Year-end Instructions," issued by the Defense Finance and Accounting Service (DFAS) Indianapolis Center.

Roles and Responsibilities. The roles and responsibilities of DFAS and its customers regarding proper and consistent preparation of the financial statements are defined in DoD 7000.14-R, volume 6, February 1996. The Regulation requires DFAS to establish procedures to ensure that the process for

¹In January 1998, after we completed our audit work, the Under Secretary of Defense (Comptroller) updated chapter 6, volume 6, DoD 7000.14-R. Chapter 6 now gives DoD guidance for the form and content of FY 1997 financial statements.

preparing financial statements is consistent, timely, and auditable, and that controls are in place to provide the accuracy of the statements. The regulation also requires DoD Components to review all financial statements prepared by DFAS to assess the accuracy of the information being reported and ensure that the amounts in the financial statements are consistent and reconcilable with the data in management reports prepared by the DoD Component customers. Beginning in FY 1996, the DFAS Indianapolis Center became responsible for preparing the CFO Act financial statements for Other Defense Organizations in accordance with the OMB and DoD Form and Content Guidance.

Audit Objective

The primary audit objective was to determine whether the DFAS Indianapolis Center consistently and accurately compiled financial data received from field accounting organizations and other sources for the financial statements for Other Defense Organizations. Specifically, we evaluated whether the compilation of Other Defense Organizations' financial information for the FY 1996 financial statements was complete, and whether the Notes to the financial statements fully disclosed material discrepancies and additional information relevant to the financial statements. We also evaluated internal controls and compliance with laws and regulations as related to our audit objectives. Appendix A discusses the audit scope and methodology and our review of the internal control program. Appendix B summarizes prior audit coverage.

Compilation of Financial Statements

The compilation process used by the DFAS Indianapolis Center needed improvements to ensure that the financial statements prepared for Other Defense Organizations were complete, consistent, accurate, and fully supported. The DFAS Indianapolis Center's year-end adjustments, totaling \$88.3 billion, to the FY 1996 trial balances submitted for Other Defense Organizations were not fully supported. The DFAS Indianapolis Center excluded \$207 million in assets, \$1.4 billion in liabilities, \$308 million in net position, and \$2.2 billion in expenses from the financial statements and did not verify that information submitted by the accounting offices was sufficient to prepare reliable and complete financial statements. The DFAS Indianapolis Center did not prepare all required Notes to the financial statements, and when prepared, the Notes were not accurate and complete. These conditions occurred because the DFAS Indianapolis Center did not:

- obtain explanations from submitting organizations for discrepancies among the accounting records and summary information provided for Other Defense Organizations during the compilation process;
- correctly program a computer application used to extract financial information from the fiscal year-end 1996 certified "Report(s) on Budget Execution," DD Form 1176;
- thoroughly review the financial information submitted by the supporting accounting offices for accuracy and completeness; and
- comply with OMB and DoD guidance for preparing and presenting the Notes to the financial statements.

As a result, the FY 1996 financial statements that the DFAS Indianapolis Center compiled for Other Defense Organizations were not reliable and did not accurately or completely present the financial condition and results of operations. Unless improvements in the compilation process are made, the financial statements for Other Defense Organizations will not be able to sustain an audit performed to meet the requirements of the CFO Act.

DFAS Indianapolis Center's Compilation Process

The DoD Form and Content Guidance provides guidance for preparing and presenting the FY 1996 financial statements to meet requirements of the CFO Act and implements the OMB Form and Content Guidance. The Deputy Director for Accounting Operations, DFAS Indianapolis Center:

- receives fiscal year-end trial balances and certified "Reports on Budget Execution," DD Forms 1176 from the supporting accounting offices for Other Defense Organizations,
- consolidates the financial information and makes year-end adjustments, and
- prepares the financial statements for Other Defense Organizations.

FY 1996 was the first year that DFAS Indianapolis Center prepared financial statements for Other Defense Organizations. The DFAS Indianapolis Center branch that prepared the Department of the Army consolidated financial statements also prepared the financial statements for Other Defense Organizations. Financial information for Other Defense Organizations was generated by at least 13 separate accounting systems. A significant portion of that information was unreliable. Therefore, for the FY 1996 financial statements, the DFAS Indianapolis Center adjusted trial balances to agree with applicable information on the certified "Reports on Budget Execution."

The time constraints imposed by the CFO Act and the priority of preparing the consolidated financial statements for the Army prevented the DFAS Indianapolis Center from fully coordinating and verifying the accuracy of its adjustments to information submitted for Other Defense Organizations.

Year-end Adjustments to the Trial Balances

The DFAS Indianapolis Center did not fully comply with the requirements in DoD 7000.14-R in making year-end adjustments to trial balances. The DFAS Indianapolis Center did not have sufficient documentation for making 47 year-end adjustments totaling \$88.3 billion because it had difficulty obtaining complete and accurate financial data from the supporting accounting offices for Other Defense Organizations. We could not determine the validity of the adjustments because of the lack of documentation. Appendix C summarizes the 47 year-end adjustments.

Complying With DoD 7000.14-R. The DFAS Indianapolis Center used the financial information in the year-end "Report(s) on Budget Execution" as the primary source for verifying the accuracy of trial balances submitted for the Other Defense Organizations. The DFAS Indianapolis Center adjusted the amounts in the trial balances with comparable information in the "Reports on Budget Execution." In FY 1996, the DFAS Indianapolis Center made 47 year-end adjustments to the Other Defense Organizations' trial balances, totaling \$88.3 billion, without a complete audit trail to supporting documentation. However, the DFAS Indianapolis Center did not notify the supporting accounting offices or request that they reconcile or explain the differences as required by DoD 7000.14-R. Volume 6 of the Regulation requires DFAS to adequately support and justify in writing any adjustment to the official accounting records. The Regulation also requires DFAS to obtain approval from the customer before recording adjustments. Implementation of

Compilation of Financial Statements

the recommendations in Inspector General (IG), DoD, Report No. 97-151, "The Fund Balance With Treasury Account for the Research, Development, Test and Evaluation Appropriation, Department 97," June 4, 1997, will correct the problems in coordinating adjustments with the affected Defense organizations.

DFAS Indianapolis Center accounting personnel did not have complete audit trails for the year-end adjustments because FY 1996 was the first year of the reporting requirements for Other Defense Organizations. Therefore, the supporting accounting offices were unable to provide DFAS Indianapolis Center with complete and reliable financial information in a timely manner. The supporting accounting offices' problems in submitting and preparing trial balances, and recommendations to correct those problems, will be addressed in an ongoing audit, "Audit of the Consolidation Process for FY 1997 Financial Statements on Other Defense Organizations," Project No. 7RF-2028.

Reasons for Year-end Adjustments. Of the \$88.3 billion in year-end adjustments, DFAS Indianapolis Center personnel made \$66.9 billion in adjustments (76 percent) to bring the Other Defense Organizations' trial balance amounts into agreement with amounts in the "Report(s) on Budget Execution." The remaining \$21.4 billion (24 percent) in year-end adjustments was to correct errors made by the supporting accounting offices for Other Defense Organizations or by DFAS Indianapolis Center. If the DFAS Indianapolis Center had complied with DoD 7000.14-R and the supporting accounting offices had submitted complete and reliable information in a timely manner, at least 76 percent of the year-end adjustments might not have been needed; or if needed, the adjustments would have been properly documented.

Accuracy and Completeness of Financial Information Reported in the Financial Statements

The DFAS Indianapolis Center did not include all appropriations in the Statement of Financial Position and the Statement of Operations and Changes in Net Position (the Statement of Operations). Also, the DFAS Indianapolis Center did not properly report liabilities for canceled² appropriations. In addition, the DFAS Indianapolis Center did not adequately review the financial information from the supporting accounting offices for Other Defense Organizations to ensure its accuracy and completeness.

Statement of Financial Position. IG, DoD, Report No. 98-027, "Comprehensiveness of the FY 1996 Other Defense Organizations Financial Statements," November 28, 1997, states that the DFAS Indianapolis Center excluded part or all of 11 canceled appropriation accounts that were reopened

²Appropriations are closed by the U.S. Treasury 5 years after obligation authority expires and remaining balances canceled, in accordance with Title 31, United States Code, Section 1553.

by the Department of the Treasury; certain canceled and merged appropriation accounts that could not be closed because of negative balances, yet were reported in the fiscal year-end 1996 "Report(s) on Budget Execution;" and portions of 14 open appropriation accounts. As a result, the assets, liabilities, and net positions for Other Defense Organizations were understated by at least \$207 million, \$1.2 billion, and \$308 million, respectively. Implementation of the recommendations in IG, DoD, Report No. 98-027 will correct the problems with the omission of closed appropriations that were reopened by the Department of the Treasury and canceled appropriations with negative balances.

Statement of Operations. The DFAS Indianapolis Center correctly excluded accounts from canceled appropriations from the FY 1996 Statement of Financial Position because the reporting entity no longer has the authority to obligate or disburse these funds. However, at least \$2.2 billion in expenses incurred during FY 1996 from appropriations canceled at the end of FY 1996 was unintentionally omitted from the Statement of Operations because of a computer programming error that excluded financial information for canceled year appropriations from the general ledger data base for Other Defense Organizations. Implementing the recommendations in IG, DoD, Report No. 98-027 will correct the problem caused by the computer programming error.

Liabilities Related to Canceled Appropriations. The DFAS Indianapolis Center also did not report liabilities for canceled appropriations in the Statement of Financial Position. DoD Form and Content Guidance requires DoD activities to recognize liabilities when they are incurred, regardless of whether they are covered by available budget resources. This includes liabilities related to canceled appropriations. The DoD Standard General Ledger provides for using General Ledger Account Code (GLAC) 2960, Accounts Payable Canceled, to reclassify accounts payable within appropriations that have been canceled. Based on information in the fiscal year-end 1996 "Reports on Budget Execution," at least \$218 million of Accounts Payable for canceled appropriations should have been reported as Accounts Payable Canceled. However, no amount was reported in the FY 1996 financial statements for Other Defense Organizations. Accounting personnel at the DFAS Indianapolis Center stated that they did not report Accounts Payable for canceled appropriations because the supporting accounting offices did not report balances for GLAC 2960. The DFAS Indianapolis Center agreed to report Accounts Payable balances for canceled appropriations in the Accounts Payable Canceled account in future financial statements.

Use of Summary Accounts. The DFAS Indianapolis Center was unable to obtain details from the supporting accounting offices on incorrect information in the summary accounts because of time constraints in preparing adjusted trial balances for the financial statements required by the CFO Act. The supporting accounting offices used 20 summary accounts to report \$23 billion in debit balances and \$16 billion in credit balances for FY 1996, rather than using the posting accounts, as required by DoD 7000.14-R.

Volume 1 of the Regulation states that a summary account is subdivided into subsidiary posting accounts and that documentation shall be maintained to

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support each subsidiary posting account. At fiscal year-end, the subsidiary posting account balances are closed to the summary accounts for financial reporting purposes. Therefore, no posting entries should be made to summary accounts. Personnel at the DFAS Indianapolis Center could not identify the posting accounts for the 20 summary accounts because supporting accounting offices submitted financial information in summary form without footnoting the details needed. The DFAS Indianapolis Center personnel reported only what they received.

Reporting the financial information using summary accounts did not affect the total balances in the financial statements. However, neither DFAS Indianapolis Center personnel nor the auditors could test the reliability of the individual lines in the financial statements and the Notes associated with these lines, which could contain misleading information because of the lack of complete supporting documentation. For example, IG, DoD, Report No. 98-028, "Personal Services and Benefits Expenses in the FY 1996 Statement of Operations and Changes in Net Position of the 'Other Defense Organizations,'" December 2, 1997, states that the Other Defense Organizations Statement of Operations for the year ended September 30, 1996, overstated personal services and benefits expenses by \$8 billion because the supporting accounting offices reported total, rather than individual, operating expenses to the DFAS Indianapolis Center. The report recommended that the DFAS Indianapolis Center require the Defense Accounting Offices to discontinue using summary accounts for expenses. In an August 11, 1997, memorandum on the reporting of FY 1997 financial information, the DFAS Indianapolis Center instructed the Defense Accounting Offices not to use summary accounts when reporting general ledger trial balances. Therefore, we did not make a recommendation to discontinue the use of summary accounts for expenses reported in the financial statements for Other Defense Organizations.

Financial Statement Disclosures

The DFAS Indianapolis Center did not prepare all required Notes³ to the financial statements, and when prepared, the Notes were not accurate and complete. This occurred because the DFAS Indianapolis Center did not comply with OMB and DoD Form and Content Guidance.

Requirements for Notes to the Financial Statements. DoD Form and Content Guidance states that when individual line items of the financial statements cannot be obtained or substituted information is shown, the deficiencies will be explained and the reasons for noncompliance annotated.

³OMB and DoD Form and Content Guidance require specific "Notes" for certain line items in the financial statements. The guidance further states that the Notes accompanying the financial statements are an "integral part" of those statements.

The DFAS Indianapolis Center did not include at least four required Notes in the financial statements or explain the reasons for departing from generally accepted accounting principles and DoD policy.

Fund Balance With Treasury for Non-Entity Assets. DoD Form and Content Guidance requires the Statement of Financial Position to include under "Fund Balance With Treasury for Non-Entity Assets" all balances in deposit, suspense, and clearing accounts that are not available to finance the entity's activities. The fiscal year-end 1996 "Report(s) on Budget Execution" showed negative balances of \$473.9 million and \$1.3 million for the Budget Clearing Account (Treasury symbol 97F3875, a clearing account) and Undistributed and Letter of Credit Differences (Treasury symbol 97F3879, a suspense account.) However, the DFAS Indianapolis Center reported a zero balance for the Fund Balance With Treasury for Non-Entity Assets in the financial statements without footnoting the reasons for the differences between the two financial records or the reasons for the departure from the DoD Form and Content Guidance.

Accounts Payable Negative Balances. The "Accounts Payable Covered by Budgetary Resources" and "Accounts Payable not Covered by Budgetary Resources" lines on the Statement of Operations showed negative balances of \$2 billion and \$48.9 million, respectively. However, the DFAS Indianapolis Center did not include a Note explaining these negative balances.

Cumulative Results of Operations - Other Appropriations and Net Results of Operations - Other Appropriations. The Under Secretary of Defense (Comptroller) removed the Cumulative Results of Operations - Other Appropriations (GLAC 3318) and Net Results of Operations - Other Appropriations (GLAC 3328) from the DoD Uniform Chart of Accounts because entities that receive appropriated funds should not have gains or losses as a result of operations. However, the supporting accounting offices reported balances for those GLACs to the DFAS Indianapolis Center. The DFAS Indianapolis Center did not ask the reporting entities to explain these balances and assumed that the reporting entities had inadvertently posted transactions to the wrong accounts. Accordingly, the DFAS Indianapolis Center made 15 adjustments totaling \$22 billion to GLAC 3318, and 16 adjustments totaling \$18 billion to GLAC 3328, transferring these balances to Transfers-in From Others Without Reimbursement (GLAC 3220) and Transfers-out to Others Without Reimbursement (GLAC 3231). However, the DFAS Indianapolis Center did not disclose in a Note that it used GLACs 3220 and 3231 to report the balances for GLACs 3318 and 3328, as reflected in the individual trial balances for Other Defense Organizations.

Liabilities for Canceled Appropriations. The DFAS Indianapolis Center did not prepare a Note explaining why \$218 million of liabilities for canceled appropriations were not included in the financial statements. DoD Form and Content Guidance requires the Statement of Financial Position to show the total amount due to Federal agencies for other liabilities not covered by budgetary authority.

Completeness of Disclosure in the Notes. OMB Form and Content Guidance states that the Notes to the financial statements shall provide

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additional disclosures necessary to make the statements fully informative and not misleading. The DFAS Indianapolis Center could have made the financial statements for Other Defense Organizations more useful by providing additional explanations in the Notes. The following eight standard Notes to the financial statements could have been modified to improve the usefulness of the financial statements.

Note 1 (Statement of Significant Accounting Policies on Accounts Receivable, Advances and Prepayments, Accounts Payable, and Net Equity); Note 2 (Fund Balance With Treasury); Note 5 (Accounts Receivable, Net); and Note 20 (Net Position). The DFAS Indianapolis Center did not explain in Notes 1, 2, 5, and 20 that the amounts from the applicable accounts reported in the financial statements were adjusted to reflect the balances from the Department of the Treasury's Government On-line Accounting Link System. The DFAS Indianapolis Center made the adjustments because the supporting accounting offices did not have complete general ledger accounting systems and other controls needed to produce accurate and reliable financial information.

Note 15 (Property, Plant, and Equipment). The DFAS Indianapolis Center did not state in Note 15 that the reported amount of Property, Plant, and Equipment was not reliable. Several IG, DoD, audit reports on the financial statements of entities included in Other Defense Organizations for FYs 1995 and 1996 stated that the accounting systems for Other Defense Organizations could not produce reliable balances for Property, Plant, and Equipment.

Note 18 (Leases). The DFAS Indianapolis Center did not prepare Note 18 describing lease arrangements, future payments due, and total future lease payments for both capital leases and operating leases, as required. Instead, leases were briefly mentioned in Note 1. According to Note 1, the Other Defense Organizations were committed to numerous operating leases and rental agreements as of September 30, 1996.

Note 23 (Program or Operating Expenses). The DFAS Indianapolis Center did not accurately disclose in Note 23 that personal services and benefits included in other operating expenses could not be individually identified because accounting offices did not provide that information.

Note 28 (Non-Operating Changes - [Transfers and Donations]). The DFAS Indianapolis Center did not disclose in Note 28 that adjustments to Transfers-In (GLAC 3220) and Transfers-Out (GLAC 3231), totaling \$5.5 billion and \$3.5 billion respectively, were not related to the actual transfer of assets to or from the Defense organizations. Instead, adjustments were used as transfer balances for two obsolete accounts, Cumulative Results of Operations (GLAC 3318) and Net Results of Operations (GLAC 3328), and as offset accounts to make the debit and credit balances equal.

Conclusion

The DFAS Indianapolis Center was able to prepare FY 1996 financial statements for Other Defense Organizations in support of the requirement in the "Federal Financial Management Act of 1994" for the DoD consolidating financial statements. However, the financial statements were not accurate, reliable, or complete. Recommendations were made in prior IG, DoD, audit reports to better coordinate adjustments with supporting accounting offices, include required financial information from canceled appropriations, correct computer programming errors, and discontinue using summary accounts. Implementing these recommendations will improve the compilation process. The DFAS Indianapolis Center should also establish controls to ensure that OMB and DoD Form and Content Guidance are followed in preparing the Notes to the financial statements. Making the recommended changes to the compilation process will help ensure that future financial statements for Other Defense Organizations are more useful, reliable, and informative.

Many of the problems cited in this report could be attributed to the unreliable and incomplete financial information reported by the supporting accounting offices for Other Defense Organizations. The IG, DoD, will continue to review the information provided to the DFAS Indianapolis Center by the supporting accounting offices and recommend improvements to assist those Defense Accounting Offices in providing more accurate and reliable information. The current audit of the FY 1997 consolidation process will also address the lack of monthly submissions of trial balances by accounting offices that support Other Defense Organizations.

Recommendations for Corrective Action

We recommend that the Director, Defense Finance and Accounting Service Indianapolis Center, establish and implement management control procedures to comply with the most current Office of Management and Budget and DoD guidance on the form and content of financial statements. Specifically, the financial statements should:

1. Include all required Notes to the financial statements.
2. Disclose deficiencies in accounting systems that could affect the reliability of balances reported in the statements.
3. Fully explain summary adjustments made during the compilation process.

Management Comments Required

A draft of this report was issued on October 27, 1997. No management comments were received. Therefore, we request that the Director, Defense Finance and Accounting Service Indianapolis Center, comment on the final report by April 6, 1998.

Part II - Additional Information

Appendix A. Audit Process

Scope and Methodology

We reviewed the year-end trial balances and "Report(s) on Budget Execution" submitted to support the FY 1996 financial statements for Other Defense Organizations and compared that information with the financial statements and associated Notes. The DFAS Indianapolis Center consolidated 682 trial balances submitted by 23 supporting accounting offices on behalf of 42 Defense organizations, funds, and accounts. The 42 Defense organizations, funds, and accounts were appropriated \$39 billion in FY 1996, and the financial statements showed total assets of \$45.7 billion, total liabilities of \$2.7 billion, revenues and financing sources of \$46.7 billion, and expenses of \$46.5 billion.

We reviewed the supporting documentation for the 47 year-end adjustments, totaling \$88.3 billion, that the DFAS Indianapolis Center made to the individual and consolidated trial balances. Our audit concentrated on the rationale that the DFAS Indianapolis Center used to make these adjustments and the adequacy of financial statement disclosures. In addition, we compared the computer program used to extract the financial information from the fiscal year-end 1996 "Report(s) on Budget Execution" to the hard copy "Reports on Budget Execution." We used the fiscal year-end 1996 "Report(s) on Budget Execution" prepared by the DFAS Indianapolis Center to calculate the dollar amount of liabilities for canceled appropriations that should have been reported in the Accounts Payable Canceled account. We also compared the information in the Notes to the financial statements with the requirements in OMB and DoD Form and Content Guidance.

Use of Computer-Processed Data. We relied on FY 1996 computer-processed data that the DFAS Indianapolis Center generated from the general ledger database to prepare the FY 1996 financial statements for Other Defense Organizations without confirming the reliability of the data received from the supporting accounting offices. DoD accounting systems that support the financial statements for Other Defense Organizations have significant limitations. The lack of reliable financial information was recognized as a material management control deficiency in the DoD FY 1996 Annual Statement of Assurance and was further confirmed in IG, DoD, Report No. 97-155 (see Appendix B). However, not validating the reliability of the data did not affect the results of the audit.

Audit Type, Dates, and Standards. We performed this financial-related audit from December 1996 through October 1997. The audit was performed in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the IG, DoD, based on the objectives of the audit and the limitations described in this appendix. We included tests of management controls considered necessary.

Contacts During the Audit. We visited or contacted individuals at the DFAS Indianapolis Center. Further details are available on request.

Internal Control Program

DoD Directive 5010.38, "Management Control (MC) Program," dated August 26, 1996, require DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

Scope of Review of the Internal Control Program. We relied on the work reported in IG, DoD, Report No. 97-155 (see Appendix B) to assess the adequacy of the DFAS Indianapolis Center's internal controls over the reporting of the FY 1996 financial information for Other Defense Organizations. We reviewed management's self-evaluation applicable to those controls.

Adequacy of Internal Controls. We identified material internal control weaknesses as defined by DoD Directive 5010.38 at the DFAS Indianapolis Center. The DFAS Indianapolis Center's internal controls for departmental financial reporting were not adequate to ensure that all adjustments to the FY 1996 financial statements for Other Defense Organizations were sufficiently researched, supported, reconciled, and documented. Also, internal controls did not ensure that adjustments were properly disclosed and explained in the financial statement Notes. The recommendations, if implemented, will correct the deficiencies. A copy of the report will be provided to the senior DFAS official responsible for internal controls.

Adequacy of Management's Self-Evaluation. Management's self-evaluation did not detect and report the internal control weaknesses identified in this report because the DFAS Indianapolis Center did not assess reconciliations and adjustments to the Defense organizations' trial balances as part of its internal control program.

Appendix B. Summary of Prior Coverage

IG, DoD, Report No. 98-029, "Revenues and Expenses from Reimbursable Activity for Other Defense Organizations," December 5, 1997. The report states that revenues from reimbursable activity were overstated by at least \$428.3 million, and expenses and Appropriated Capital Used related to reimbursable activity were each overstated by \$4.4 billion. Also, the accounting offices supporting Other Defense Organizations used different GLACs to record and report the same types of revenues and expenses from reimbursable activity. As a result, the FY 1996 Statement of Operations did not accurately present the results of operations. The report recommended that DFAS establish procedures to verify that revenues and expenses from reimbursable activity are included only once in the Statement of Operations, and that accounting adjustments be fully supported to avoid distorting the financial statements. The report also recommended that Defense organizations record revenues based on earnings, rather than on obligations; verify the accuracy of reimbursable activity reported; and (for appropriated funds) accrue revenues and expenses for reimbursable activity during the same accounting period. All Defense organizations except DFAS generally concurred with the report and agreed to implement the recommendations. DFAS had not responded to Report No. 98-029 when the present report was issued. The report also recommended that the Under Secretary of Defense (Comptroller) clarify guidance on how to account for and report revenues and expenses from reimbursable activity. The Under Secretary of Defense (Comptroller) concurred with the recommendations.

IG, DoD, Report No. 98-028, "Personal Services and Benefits Expenses in the FY 1996 Statement of Operations and Changes in Net Position of the "Other Defense Organizations," December 2, 1997. The report states that the Statement of Operations and Changes in Net Position for Other Defense Organizations for the year ended September 30, 1996, misclassified \$8 billion in various operating expenses as personal services and benefits expenses. As a result, the operating expense portion of the Statement of Operations and Changes in the Net Position could not be relied on to accurately present FY 1996 personal services and benefits expenses. The report recommended that the Director, DFAS Indianapolis Center, require accounting offices to report operating expenses by individual, rather than summary, general ledger expense accounts. DFAS concurred and revised the reporting instructions to emphasize the requirements for detailed general ledger accounts.

IG, DoD, Report No. 98-027, "Comprehensiveness of the FY 1996 Other Defense Organizations Financial Statements," November 28, 1997. The report states that the FY 1996 financial data prepared by the DFAS Indianapolis Center for the Other Defense Organizations financial statements were not comprehensive. The DFAS Indianapolis Center excluded from the FY 1996 financial statements:

- either part or all of 11 appropriation accounts that were reopened by the Department of the Treasury;

Appendix B. Summary of Prior Coverage

- certain canceled and merged appropriation accounts that could not be closed because of negative balances; and
- portions of 14 open appropriation accounts.

As a result, the amounts shown for six GLACs in the Statement of Financial Position were inaccurate. The report recommended that the Director, DFAS Indianapolis Center:

- report the total operations of Other Defense Organizations as reflected in the fiscal year-end "Report(s) on Budget Execution," and make appropriate adjustments to the FY 1997 beginning balances;
- change the computer program to include the total operations of Other Defense Organizations and adjust the beginning balance of accounts to be included in the FY 1997 Statement of Financial Position; and
- review the staffing requirements needed to successfully compile the financial statements for Other Defense Organizations.

DFAS stated that DoD policy prohibited making changes to prior-year balances on the financial statements. DFAS concurred with the remaining recommendations and stated that corrective actions were being taken.

IG, DoD, Report No. 97-215, "Reporting of Accounts Payable for the National Guard and Reserve Equipment Appropriation on the 'Other Defense Organizations' Portion of the FY 1996 Financial Statements," September 18, 1997. The report states that the DFAS Cleveland and Indianapolis Centers did not report accounts payable remaining on closed appropriations for the National Guard and Reserve Equipment Appropriation. As a result, Accounts Payable for the National Guard and Reserve Equipment Appropriation was understated by \$12.8 million in the FY 1996 financial statements. The report recommended that the Under Secretary of Defense (Comptroller) revise the "DoD Guidance on Form and Content of Financial Statements for FY 1997 Financial Activity" to specify the reporting treatment of Accounts Payable for closed appropriations. The Under Secretary of Defense (Comptroller) did not comment on the report.

IG, DoD, Report No. 97-155, "Internal Controls and Compliance with Laws and Regulations for the FY 1996 Financial Statements of the 'Other Defense Organizations' Receiving Department 97 Appropriations," June 27, 1997. The report states that the consolidated Principal Statements for Other Defense Organizations were not accurate and reliable. Unless accounting systems and internal controls are improved, the future financial statements for Other Defense Organizations will not be reliable. The DFAS Indianapolis Center and the accounting offices supporting Other Defense Organizations were unable to fully comply with applicable laws and regulations. As a result, the Other Defense Organizations were not in full compliance with the CFO Act and the Federal Managers' Financial Integrity Act. The report recommended that the Director, DFAS Indianapolis Center, maintain records for audit trails of all adjustment transactions; reconcile the current-year Department 97 expenditure

Appendix B. Summary of Prior Coverage

data for the Fund Balance With Treasury account to the Department of the Treasury data; and document the review process used and the decision made regarding the auditors' recommended adjustments to the Principal Statements, including the Notes. The DFAS Indianapolis Center generally concurred with the recommendation to maintain audit trails and suggested that it also be directed to the Defense organizations included in the Other Defense Organizations entity. The DFAS Indianapolis Center concurred with the recommendations to establish procedures for reviewing auditor-recommended adjustments with the auditors, and stated that DFAS will work closely with the IG, DoD, in future years to develop a mutually agreeable process to coordinate auditor-recommended adjustments and Note disclosures.

IG, DoD, Report No. 97-151, "The Fund Balance With Treasury Account for the Research, Development, Test and Evaluation Appropriation, Department 97," June 4, 1997. The report states that the DFAS Indianapolis Center did not make two material disclosures in the Notes report to the Department of the Treasury regarding the Research, Development, Test and Evaluation Appropriation, Department 97 Fund Balance With Treasury account. The material disclosures were a \$1 billion reduction, and the amount reported as the Department 97 Fund Balance With Treasury was the amount shown in the Department of the Treasury's accounting system, not the amount generated from the Defense organizations' accounting systems. The DFAS Indianapolis Center did not notify the affected Defense organizations of the adjustments it made to their trial balances. If the DFAS Indianapolis Center had used the same practices to prepare the Notes report for FY 1996, the Notes report would have contained unreliable information. As a result of the audit, the DFAS Indianapolis Center took corrective action to disclose the adjustments in the FY 1996 Notes report. The report recommended that the Director, DFAS Indianapolis Center, coordinate the research to determine the causes of the differences between fiscal year-end "Report(s) on Budget Execution" and general ledger trial balances, and fully disclose the basis for adjustments made to the Department of the Treasury fund balance. The DFAS Indianapolis Center partially concurred with the recommendations and stated that it plans to coordinate and make the FY 1997 adjustments that are identifiable to specific accounting activities. In addition, the DFAS Indianapolis Center plans to make the required disclosures in the FY 1997 and future financial statements.

IG, DoD, Report No. 97-079, "Documentation of the Federal Financial System Process at the Defense Finance and Accounting Service Indianapolis Center," January 24, 1997. The report states that the DFAS Indianapolis Center's process for receiving, adjusting, and consolidating the general ledger trial balances from fiscal stations was not documented as required by DoD 7000.14-R. As a result, general ledger account balances cannot be readily or effectively tested to ensure the reliability of the general ledger trial balances reported for Department 97 appropriations. The report recommended that the DFAS Indianapolis Center document the process for receiving, adjusting, and consolidating the general ledger trial balances received from fiscal stations. The Director, DFAS Indianapolis Center, agreed to document the process of receiving, adjusting, and consolidating the general ledger trial balances received to formulate the financial statements for Other Defense Organizations.

Appendix C. Summary of Year-End Adjustments

As part of the consolidation process for the FY 1996 financial statements for Other Defense Organizations, the DFAS Indianapolis Center prepared 47 journal vouchers to the individual trial balances at year-end, totaling \$88.3 billion. These adjustments fall into four general categories.

<u>Number of Journal Vouchers</u>	<u>Amount</u>	<u>Percent of Total Adjustments</u>	<u>Purpose of Making Adjustments</u>
5	\$66,891,852,000	75.7	To bring trial balance data into agreement with year-end "Reports on Budget Execution."
1	13,502,790,000	15.3	To adjust the general ledger database to record Appropriated Capital Used.
39	7,911,019,000	9.0	To remove invalid and duplicate data and correct the data in the general ledger database.
2	10,407,000	0.0	To bring the general ledger database into agreement with the Department of the Treasury's trial balance.
<u>47</u>	<u>\$88,316,068,000</u>	<u>100.0</u>	Totals

Appendix D. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Assistant Secretary of Defense (Public Affairs)
Director, Joint Staff
Director, Defense Logistics Studies Information Exchange

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Unified Command

Commander in Chief, U.S. Special Operations Command

Other Defense Organizations

Director, Defense Advanced Research Projects Agency
Director, Ballistic Missile Defense Organization
Director, Defense Contract Audit Agency
Director, Defense Finance and Accounting Service
Director, Defense Finance and Accounting Service Cleveland Center
Director, Defense Finance and Accounting Service Columbus Center
Director, Defense Finance and Accounting Service Denver Center
Director, Defense Finance and Accounting Service Indianapolis Center
Director, Defense Information Systems Agency

Other Defense Organizations (cont'd)

Director, Defense Intelligence Agency
Inspector General, Defense Intelligence Agency
Director, Defense Investigative Service
Director, Defense Logistics Agency
Director, Defense Special Weapons Agency
Director, National Imagery and Mapping Agency
Inspector General, National Imagery and Mapping Agency
Director, National Security Agency
Inspector General, National Security Agency
Director, On-Site Inspection Agency
Director, American Forces Information Service
Director, Department of Defense Education Activity
Director, TRICARE Support Office
Director, Washington Headquarters Services
President, Uniformed Services University of the Health Sciences

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
Technical Information Center, National Security and International Affairs Division,
General Accounting Office

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal
Justice, Committee on Government Reform and Oversight
House Committee on National Security

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